

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Leach Analyst: Roger Lackey Bill Number: AB 1970
Related Bills: None Telephone: 845-3627 Introduced Date: 02-18-00
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Repeal Limited Liability Company Fee Adjustment

SUMMARY

This bill would repeal the existing state law requiring the Franchise Tax Board (FTB) to conduct a study of the Limited Liability Company (LLC) Fee annually and subsequently adjust that fee upon certain findings.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately upon signature and would be operative for taxable years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

Existing state law authorizes the creation of an LLC and the registration of LLCs created under the laws of other states. The tax treatment of an LLC under existing state law depends upon its classification for tax purposes.

In general, if an LLC has more than one owner (known as a "member"), it is classified as a partnership for federal and state tax purposes unless it elects to be classified as a corporation. If an LLC has a single member, its existence as an entity separate from its owner will be disregarded for federal and state tax purposes unless it elects to be classified as a corporation.

Existing state law provides that every LLC not classified as a corporation (i.e., classified as a partnership or disregarded) that is organized in this state, registered in this state, or doing business in this state shall be subject to an annual tax in an amount equal to the minimum franchise tax until the effective date of cancellation or, if later, the date the entity ceases to do business within the state.

Existing state law further provides that an LLC not classified as a corporation also shall pay an annual fee based on the total income from all sources reportable to this state for the taxable year. For example, for taxable years beginning on or after January 1, 1997, an LLC with total income for the taxable year greater than \$250,000, but less than \$500,000, would pay a fee equal to \$500. As the total income for the year increases, the fee increases to a maximum amount of \$4,500 based on a total income that exceeds \$5 million.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Alan Hunter for GHG

3/20/00

As required by **state law**, the Franchise Tax Board (FTB) developed a report setting forth the methodology and assumptions used to determine the effect of recognizing LLCs on state tax revenues, which was submitted to the Joint Legislative Budget Committee in 1994. In 1999, the FTB began conducting an annual revenue estimate using the specified methodologies and assumptions set forth in the 1994 report. This estimate determines if state tax revenues have increased or decreased as a result of business entities organizing as LLCs in California rather than choosing other traditional forms of business organizations (e.g., corporations, partnerships, etc.). The state law requires that if the FTB estimate results in a net gain or reduction in state revenues because of the recognition of LLCs, the FTB is required, after a public hearing, to adjust the schedule of LLC fees to balance the revenue impact of LLCs.

The FTB conducted the study for the years 1999 and 2000. The fee was increased for 1999 and is currently proposed to be increased for 2000, as indicated in the chart below.

<u>Initial Fee</u>	<u>1999 Fees</u> <u>(Actual)</u>	<u>2000 Fees</u> <u>(Proposed)</u>	<u>Total income</u>
\$ 500	\$ 865	\$1,042	\$250,000 or more, but less than \$500,000
\$1,500	\$2,595	\$3,126	\$500,000 or more, but less than \$1,000,000
\$3,000	\$5,190	\$6,251	\$1,000,000 or more, but less than \$5,000,000
\$4,500	\$7,785	\$9,377	\$5,000,000 or more.

The public hearing for the 2000 proposed fee increase was held, March 13, 2000, at the FTB.

This bill would repeal the FTB's annual study and estimate of the LLC Fee and the FTB's authority to make a subsequent adjustment of the fee based upon the findings. Therefore, the fee structure in effect prior to the 1999 fee adjustment would apply to 2000 and all future tax years.

Implementation Considerations

The statute providing for the LLC fee and the initial fee amounts (Section 17942 of the Revenue and Taxation Code) is independent of the statute (Section 17943 of the Revenue and Taxation Code) providing for the annual study of the LLC fee and the subsequent adjustment to the fee. As a result, if the annual study of the LLC fee and the subsequent adjustment to the fee are repealed, nothing in statute would provide for the 1999 fee amounts or the fee adjustment proposed for 2000. As a result, for the 2000 tax year, the LLC fee would revert back to the initial fee amounts established in the statute.

Implementing this bill would not significantly impact the department's programs and operations.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Based on limited data, revenue losses from this bill are projected to be as follows:

Estimated Revenue Impact of AB 1970 Taxable Years Beginning After 12/31/1999 and Enactment Assumed After 6/30/2000 (In \$Millions)			
Fiscal Years	2000-01	2001-02	2002-03
Revenue Impact (Rounded)	(\$45)	(\$50)	(\$55)

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Tax Revenue Discussion

Repealing Section 17943 of the Revenue and Taxation Code would return the limited liability company fees back to the Section 17942 specification.

According to available departmental data, nearly 95,000 LLC returns were received for the 1998 tax year, with \$26.5 million in fees paid. Under current law, higher fees were imposed for 1999, and fees will be further increased for 2000. Thus, the projected revenue loss.

BOARD POSITION

Pending.